

**Statement of
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Fitch Ratings
To
United States Senate
Committee on Banking, Housing and Urban Affairs
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Introduction

Fitch Ratings traces its roots to the Fitch Publishing Company established in 1913. In the 1920s, Fitch introduced the now familiar “AAA” to “D” rating scale. Fitch was one of the three rating agencies (together with Standard & Poor’s (“S&P”) and Moody’s Investors Service (“Moody’s”)) first recognized as a nationally recognized statistical rating organization (a so-called “NRSRO”) by the Securities and Exchange Commission (“SEC”) in 1975.

Since 1989 when a new management team recapitalized Fitch, Fitch has experienced dramatic growth. Throughout the 1990s, Fitch especially grew in the new area of structured finance by providing investors with original research, clear explanations of complex credits and more rigorous surveillance than the other rating agencies.

In 1997, Fitch merged with IBCA Limited, another NRSRO headquartered in London, significantly increasing Fitch’s worldwide presence and coverage in banking, financial institutions and sovereigns. Through the merger with IBCA, Fitch became owned by Fimalac, a holding company that acquired IBCA in 1992. The merger of Fitch and IBCA represented the first step in our plan to respond to investors’ needs for an alternative global, full-service rating agency capable of successfully competing with Moody’s and S&P across all products and market segments.

Our next step in building Fitch into a global competitor was our acquisition of Duff & Phelps Credit Rating Co., an NRSRO headquartered in Chicago, in April 2000 followed by the acquisition later that year of the rating business of Thomson BankWatch. These acquisitions strengthened our coverage in the corporate, financial institution, insurance, and structured finance sectors, as well as adding a significant number of international offices and affiliates.

As a result of this growth and acquisitions, Fitch today has approximately 1,600 employees, including over 750 analysts, in over 49 offices and affiliates worldwide. Fitch currently covers over 4,400 corporations, banks and financial institutions, 86

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sovereigns and 40,000 municipal offerings in the United States. In addition, we cover over 7,500 issues in structured finance, which remains our traditional strength.

Fitch is in the business of publishing research and independent ratings and credit analysis of securities issued around the world. A rating is our published opinion as to the creditworthiness of a security, distilled into a simple, easy to use grading system (“AAA” to “DDD”). Fitch typically provides explanatory information with each rating.

Rating agencies gather and analyze a variety of financial, industry, market and economic information, synthesize that information, and publish independent, credible assessments of the creditworthiness of securities and issuers, thereby providing a convenient way for investors to judge the credit quality of various alternative investment options. Rating agencies also publish considerable independent research on credit markets, industry trends and economic issues of general interest to the investing public.

By focusing on credit analysis and research, rating agencies provide independent, credible and professional analysis for investors more efficiently than investors could perform on their own.

We currently have hundreds of institutional investors, financial institutions and government agencies subscribing to our research and ratings, and thousands of investors and other interested parties that access our research and ratings through our free web site and other published sources and wire services such as Bloomberg, Business Wire, Dow Jones, Reuters, and The Wall Street Journal.

A diverse mix of both short-term and long-term investors uses our ratings as a common benchmark to grade the credit risk of various securities.

In addition to their ease of use, efficiency and widespread availability, we believe that credit ratings are most useful to investors because they allow for reliable comparisons of credit risk across diverse investment opportunities.

Credit ratings can accurately assess credit risk in the overwhelming majority of cases and have proven to be a reliable indicator for assessing the likelihood that a security will default. Fitch’s most recent corporate bond and structured finance default studies are summarized below.

Fitch Average Annual Default Rates

	Corporate Finance* 1990 - 2003	Structured Finance** 1991 - 2003
AAA	0.00%	0.00%
AA	0.00%	0.01%
A	0.05%	0.02%
BBB	0.38%	0.11%
BB	1.93%	0.48%
B	2.33%	1.15%
CCC - C	27.20%	15.57%
Investment Grade	0.12%	0.03%
Non Investment Grade	4.33%	1.54%

* Based on Fitch-rated global corporate debt issuers.

** Based on Fitch-rated U.S. structured finance bonds.

The performance of ratings by the three major rating agencies is quite similar. We believe this similarity results from the common reliance on fundamental credit analysis and the similar methodology and criteria supporting ratings.

Through the years, NRSRO ratings also have been increasingly used in safety and soundness and eligible investment regulations for banks, insurance companies and other financial institutions. While the use of ratings in regulations has not been without controversy, we believe that regulators rely on ratings for the same reason that investors do: ease of use, widespread availability and proven performance over time.

Although one can use other methods to assess the creditworthiness of a security, such as the use of yield spreads and price volatility, we believe that such methods, while valuable, lack the simplicity, stability and track record of performance to supplant ratings as the preferred method used by investors to assess creditworthiness.

However, we also believe that the market is the best judge of the value of ratings. We believe that if ratings begin to disappoint investors they will stop using them as a tool to assess credit risk and the ensuing market demand for a better way to access credit risk will rapidly facilitate the development of new tools to replace ratings and rating agencies.

Regulatory Review of Rating Agencies

Beginning in 2002, the SEC began a thorough study of rating agencies that included informal discussions with Fitch and the other rating agencies, a formal examination of our practices and procedures, and two full days of public hearings in November 2002 in which we participated. Following the passage of the Sarbanes-Oxley Act of 2002, the

SEC issued its *Report on the Role and Function of Credit Rating Agencies in the Operation of the Securities Market* in January 2003. In June of 2003, the SEC issued a concept release, *Rating Agencies and the Use of Credit Ratings under the Federal Securities Laws*, soliciting public comment on a variety of issues concerning credit rating agencies.

In the international arena, in the summer of 2003, a working group of the International Organization of Securities Commissions (IOSCO), under the leadership of SEC Commissioner Roel Campos, began its study of the credit rating agencies. Fitch was an active participant in the IOSCO process that ultimately led to the publication by IOSCO of the *Statement of Principles Regarding the Activities of the Credit Rating Agencies* in September 2003 and the *Code of Conduct Fundamentals for Credit Rating Agencies* at the end of last year.

Given the importance of credit ratings in the financial market, we agree that there is a strong need for credit rating agencies to maintain high standards. For that reason, throughout the past three years Fitch has participated actively in the dialogue at the SEC, IOSCO, and on a local level throughout the world about the role and function of the rating agencies in the worldwide capital markets.

Fitch supports the four high-level principles outlined by IOSCO as announced in its *Principles* in September 2003, which the IOSCO Code complements. These four principles include transparency and symmetry of information to all market participants, independence, and freedom from conflict of interest. We are supportive of the IOSCO Code and we believe that our present operating policies and practices exemplify the principles of the IOSCO Code and will continue to work with all capital markets participants to refine “best practices” for the ratings industry. We plan to publish our formal code of conduct, together with our existing policies that complement it, by the end of the first quarter of this year.

Testimony

Set forth below is a summary of our views on the issues we understand the Committee on Banking, Housing, and Urban Affairs intends to explore at its hearing *Examining the Role of Credit Rating Agencies in the Capital Markets*.

I. NRSRO RECOGNITION PROCESS AND CRITERIA

We believe that the SEC should formalize the process by which it recognizes rating organizations. The application process, specific recognition criteria and time frames for action on all applications should be specified in appropriate regulations. We believe public comment should be solicited on applications and an appropriate appeal process should be put in place.

The criteria for recognition should include an evaluation of the organization's resources, its policies to avoid conflicts of interest and prevent insider trading and the extent to which market participants use the organization's ratings. Most importantly, however, recognition should be based upon the organization demonstrating the performance of their ratings over time by publication of actual default rates experienced in rating categories and transition studies showing the actual movement of ratings over time. When considering a rating organization for possible recognition, we believe the SEC should evaluate the default and transition experience of each organization's ratings against a benchmark reflecting the aggregate, historical default and transition rates of all ratings issued by rating agencies in the market. Ultimately, we believe that recognition should be reserved for those organizations that prove the performance of their ratings over time relative to the performance of other rating systems.

We also believe that the SEC should continue the practice of limited recognition that acknowledges the special expertise of smaller organizations in selected areas of specialty or geographic regions such as the prior recognition afforded to IBCA and BankWatch for their expertise in financial institution analysis.

Fitch does not believe that a criterion for recognition should be adherence to generally accepted industry standards. In fact, such industry standards do not exist in the case of credit rating agencies and we believe that it would be detrimental to introduce them. Ratings are opinions, and as such are based on differing criteria, qualitative and quantitative, in each agency. The market benefits from this diversity of opinion, and demands it. Requiring that a rating agency abide by strict standards would create a situation in which each agency would produce the same result on each credit and there would be no need for competing agencies or any benefit from competing agencies.

II. EXAMINATION AND OVERSIGHT OF NRSROS

Fitch acknowledges the Commission's right to revoke the recognition of any NRSRO that no longer meets the criteria for recognition. Given the importance of credit ratings in the financial markets, we believe this is an important need. As we discussed in connection with the criteria for recognition, we also believe that the examination and oversight of NRSROs should be principally focused on the performance of a rating organization's ratings over time relative to the performance of other rating systems. Accordingly, we believe that the Commission's principal oversight function should be to evaluate regularly the default and transition experience of each organization's ratings against an aggregate benchmark. Additionally, we also acknowledge the importance of our adherence to policies designed to prevent the misuse of inside information and the need of the Commission to ensure compliance with these important policies.

In addition, we believe that any oversight should be narrowly tailored to recognize the constitutional rights of the rating agencies, which function as journalists and thus should be afforded the high level of protection guaranteed by the First Amendment. An excessive amount of interference with the business of rating agencies would both violate

the First Amendment rights of the agencies and remove some of the flexibility in the ratings process that is critical to objective and timely ratings.

Within this framework, a narrowly tailored oversight scheme specific to rating agencies should be developed. While the rating agencies currently file voluntarily under the Investment Advisor's Act, this is not a "good fit," as our agencies function as journalists, providing analysis and opinion, and not as investment advisers. As the Supreme Court recognized in *Lowe*, Congress "did not seek to regulate the press through the licensing of non-personalized publishing activities" when it enacted the Investment Advisors Act, but rather was "primarily interested in regulating the business of rendering personalized investment advice." *Lowe v. SEC*, 472 U.S. 181, 204 (1985). Fitch does not provide any personalized investment advice; indeed, even Fitch's non-personalized ratings do not make any recommendations to buy or sell particular securities, but rather simply analyze the creditworthiness of a security, a point noted by the SEC staff in its June 4, 2003 response to questions from Congressman Richard H. Baker. Fitch is therefore not an "investment advisory business" within the meaning of the Investment Advisors Act and to try to make the Investment Advisors Act apply to Fitch and other rating agencies would not be productive.

In the same vein, it would be unsound to seek to impose a diligence requirement on rating agencies either for purposes of creating a private right of action or for oversight purposes. Even putting aside the significant and in our view insurmountable issues of statutory authority and constitutionality, rating agencies do not now audit or verify the information on which they rely, and to impose such a requirement would duplicate the work of the various professionals (auditors, lawyers, investment bankers and fiduciaries) upon whom the law does place certain obligations of diligence and due care.

III. CONFLICTS OF INTEREST

Over the years, there has been considerable discussion about the fact that the current NRSROs derive a significant portion of their revenue from the ratings fees charged to issuers of rated securities. Fitch does not believe that the fact that issuers generally pay the rating agencies' fees creates an actual conflict of interest, i.e., a conflict that impairs the objectivity of the rating agencies' judgment about creditworthiness reflected in ratings. Rather, it is more appropriately classified as a *potential* conflict of interest, i.e., something that should be disclosed and managed to ensure that it does not become an actual conflict. We believe the measures that Fitch uses to manage the potential conflict adequately prevent an actual conflict of interest from arising.

Charging a fee to the issuer for the analysis done in connection with a rating, dates back to the late 1960s. Investors, who are the ultimate consumers of the rating agency product, are quite aware of this.

By way of context, Fitch's revenue comes from two principal sources: the sale of subscriptions for our research, and fees paid by issuers for the analysis we conduct with

respect to ratings. In this we are similar to other members of the media who derive revenue from subscribers and advertisers that include companies that they cover. Like other journalists, we emphasize independence and objectivity because our independent, unbiased coverage of the companies and securities we rate is important to our research subscribers and the marketplace in general.

Fitch goes to great lengths to ensure that our receipt of fees from issuers does not affect our editorial independence. We have a separate sales and marketing team that works independently of the analysts that cover the issuers. In corporate finance ratings, analysts generally are not involved in fee discussions. Although structured finance analysts may be involved in fee discussions, they are only the most senior analysts who understand the need to manage any potential conflict of interest.

We also manage the potential conflict through our compensation philosophy. The revenue Fitch receives from issuers covered by an analyst is not a factor in that analyst's compensation. Instead, an analyst's performance, such as the quality and timeliness of research, and Fitch's overall financial performance determine an analyst's compensation. Similarly, an analyst's performance relative to his or her peers and the overall profitability of Fitch are what determine an analyst's bonus. The financial performance of an analyst's sector or group does not factor into their bonuses.

Fitch does not have an advisory relationship with the companies it rates. It always maintains full independence. Unlike an investment bank, our fees are not based on the success of a bond issue or tied to the level of the rating issued. The fee charged an issuer does not go up or down depending on the ratings assigned or the successful completion of a bond offering.

Our fee is determined in advance of the determination of the rating and we do not charge a fee for a rating unless the issuer agrees in advance to pay the fee. While we do assign ratings on an unsolicited basis, we do not send bills for unsolicited ratings. Any issuer may terminate its fee arrangement with Fitch without fear that its rating will be lowered, although we do reserve the right to withdraw a rating for which we are not paid or if there is insufficient investor interest in the rating to justify continuing effort to maintain it.

As noted above, Fitch believes that the disclosure of the arrangement by which an issuer pay fees to Fitch in connection with Fitch's ratings of the issuer is appropriate. Accordingly, Fitch currently discloses that it receives fees from issuers in connection with our ratings as well as the range of fees paid. This has been our practice for sometime.

Another concern discussed by the SEC in the Concept Release is that subscribers have preferential access to rating analysts and may obtain information about a rating action before it is available to the general public. This concern is completely unwarranted in the case of Fitch. Fitch takes great efforts to ensure that all members of the public have

access to our ratings and may discuss those ratings with our analysts, whether or not those interested parties are subscribers.

All public ratings and rating actions are widely disseminated through our web sites and international wire services. Except for prior notification to the issuer of a rating or rating action, Fitch never selectively discloses ratings and rating actions to any subscriber or any other party. Fitch's ratings and related publications, including those detailing rating actions, are widely available through our public web sites and wire services free-of-charge and there are no prior communications of rating actions to subscribers.

Fitch analysts do regularly conduct informal conversations with investors, other members of the financial media, and interested parties discussing our analysis and commentary, but as a matter of policy, those conversations can never go beyond the scope of our published analysis or communicate any nonpublic information. We believe that making our analysts available to anyone interested in discussing our analysis is a valuable service to investors and the capital markets at large. The contact information for the principal analysts and other key contact people at Fitch is included in every item we publish for the purpose of facilitating interested parties posing questions to our analysts. Anyone can call our analysts free-of-charge and discuss our analysis with them, whether or not the person is a subscriber to our subscription services.

From time to time, we also hold free telephone conferences that are available to anyone interested, at which our analysts will discuss our published analysis and criteria and take questions from the participants. These telephone conferences are publicly announced in the same manner our ratings and rating actions are disseminated.

We also sponsor conferences throughout the world, as well as participate in conferences sponsored by others (which may sometimes require payment of a registration fee) at which our analysts will discuss our published analysis and criteria. Fitch publicly advertises these conferences and all are welcome.

In addition, we firmly believe that existing antifraud remedies are sufficient to deter any inappropriate disclosures by rating agencies to subscribers or any other parties.

Concern has also been raised about the potential conflicts of interest that may arise when rating agencies develop ancillary fee-based businesses. Over the years, revenue derived by Fitch from non-rating sources, including consulting and advisory services has been minimal. Historically, the bulk of such services related to providing customized ratings, performance, or scoring measures and were usually provided to subscribers of our subscription products, which were not necessarily entities that we rate.

In the fourth quarter of 2001, Fitch Group, Fitch Ratings' parent company established Fitch Risk Management, Inc. ("FRM"), a newly formed company offering risk management services, databases and credit models to help financial institutions and other companies manage both credit and operational risk. Fitch Ratings and FRM are subject

to a “fire wall” policy and FRM has its own employees, offices, and marketing staff. Fitch Group recently acquired Algorithmics, a leading provider of enterprise risk management solutions. Algorithmics, part of FRM, is subject to the same “fire wall” policies.

Based on the above-described procedures regarding issuer payment of fees, selective disclosure and ancillary services, Fitch believes that it adequately addresses any potential conflict of interest. In fact, we believe that the suggestions proposed in both the SEC Concept Release and the provisions of the IOSCO Code to protect against conflicts of interest have already been in large part adopted by Fitch. However, Fitch would not oppose narrowly tailored conditions to SEC recognition that ensure that these standards continue.

IV. TRANSPARENCY

We believe quite strongly that the process and procedure that rating agencies use should be transparent. Accordingly, at Fitch, there are hundreds of criteria reports published highlighting the methodology we use to rate various types of entities and securities, together with detailed sector analysis on a broad array of sectors, companies, and issues, all available free on our web site (www.fitchratings.com). Fitch has also been a leader in publishing presale reports in the areas of structured finance, global power, project finance, and public finance, where our published analysis of various transactions of interest to the market is made available free of charge on our web site prior to the pricing of the transaction. In addition, Fitch makes available free of charge on our web site all of our outstanding ratings. Fitch also distributes announcements of rating actions through a variety of wire services as mentioned above.

However, certain of our publications and data are only available to our paid subscribers. We commit extensive time and resources to producing our publications and data and we believe they are valuable to anyone interested in objective credit analysis. In this practice, we are no different from other members of the financial media, such as Bloomberg, Dow Jones, Thomson Financial and others that charge subscribers for access to their publications and data services.

While we believe that for the most part credit rating agencies have adequate access to the information they need to form an independent and objective opinion about the creditworthiness of an issuer, Fitch would welcome improved disclosure by issuers. As we found in our various published studies of the use of credit derivatives in the global market, financial reporting and disclosure with respect to areas such as credit derivatives, off-balance sheet financing, and other forms of contingencies vary greatly by sector, and comparability is further obscured by differences in international reporting and accounting standards.

As the SEC noted in their Report, issuers provide rating agencies with nonpublic information as part of the rating process. The nature and level of nonpublic information

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provided to Fitch varies widely by company, industry and country. Nonpublic information frequently includes budgets and forecasts, as well as advance notification of major corporate events such as a merger. Nonpublic information may also include more detailed financial reporting.

While access to nonpublic information and senior levels of management at an issuer is beneficial, Fitch can form an objective opinion about the creditworthiness of an issuer based solely on public information in many jurisdictions. Typically, it is not the value of any particular piece of nonpublic information that is important to the rating process, but that access to such information and to senior management that assists us in forming a qualitative judgment about a company's management and prospects.

Another factor critical to the adequate flow of information to and from the rating agencies is the understanding that information can be provided to a rating agency without necessitating an intrusive and expensive verification process that would largely if not entirely duplicate the work of other professionals in the issuance of securities. Thus, as noted by the SEC Report, rating agencies do not perform due diligence or conduct audits, but do assume the accuracy of the information provided to them by issuers and their advisors. Since rating agencies are part of the financial media, we believe that our ability to operate on this assumption, and to exercise discretion in deciding how to perform our analysis and what to publish, is protected by the First Amendment.